

# **Arkle Master Issuer plc**

**Annual Report and Accounts**

**Year ended 31 December 2009**

**Company number : 05941709**

## DIRECTORS' REPORT

The directors have pleasure in presenting their report and the audited financial statements for Arkle Master Issuer plc ("the Company") for the year to 31 December 2009.

### Principal activities

The principal activities of the Company are the investment of the proceeds of the issue of publicly listed floating and fixed rate asset backed loan notes in the international capital markets which are denominated in US and Canadian Dollars, Euro and Sterling (the "Notes"). These proceeds have been invested in loans to a related undertaking. No future changes in activity are envisaged.

The Company was registered as Arkle Master Issuer plc in England and Wales on 20 September 2006 as a public limited company, with authorised share capital of £50,000 comprising 50,000 ordinary shares of £1 each. All of the authorised share capital of £50,000 was issued, of which 49,999 shares were partly paid to £0.25 each and one share was fully paid up.

The activities of the Company are conducted primarily by reference to a series of securitisation transaction documents (the "Programme Documentation"). The securitisation structure has been established as a means of raising finance for Lloyds TSB Bank plc and subsequently Lloyds Banking Group plc ("LBG"). The Programme Documentation sets out the workings of the transaction and the principal risks to the holders of the Notes. As such, these have not been reproduced in full in the accounts.

### Results and dividends

The profit on ordinary activities before tax for the year to 31 December 2009 was £33,192,000 (31 Dec 2008: £20,951,000 loss). No dividends were paid during the year (2008: £nil). The profit before tax for the year includes a fair value movement on financial instruments of £33,187,000 (2008: £20,956,000 loss) which reflects the current market value of the derivatives. The debt securities are effectively hedged using derivative contracts and so gains or losses are expected to reverse in the future.

Profits on a cashflow basis are pre-determined under the Programme Documentation. Under the terms of the inter-company loans, the Company has the right to a profit before tax of £5,000 from available revenue receipts per accounting period.

### Business review and future developments

During the year, £7,951 million of notes were repaid on their expected payment dates. During the year, Lloyds TSB Bank plc provided a total of £3,848 million re-financing contribution to Arkle Funding (No.1) Limited ("Funding 1") to repay the full principal due on the intercompany loan and subsequently the Notes.

The Company will continue to issue notes and invest the proceeds as intercompany loans to Funding 1. The directors anticipate that the Company will be profitable over its lifetime.

### Key Performance Indicators (KPIs)

Given the straight forward nature of the business, the Company's directors are of the opinion that analysis using KPIs is not necessary for an understanding of the development, performance or position of the Company. However, a defined set of KPIs for the securitisation transaction are set out in the Programme Documentation and published as a monthly Investor Report (available via the LBG website). Performance against the KPIs include the yield on the Trust available as the first line of credit enhancement to the Notes, the losses that have occurred and the level of arrears in the underlying mortgages, the rate of repayment of the loans within the Trust and an analysis of the characteristics of the underlying mortgages in the Trust. An extract of these are shown in Note 18.

The key performance indicator used by management in assessing the performance of the Company is the monitoring of actual cash flows against planned cash flows.

At the time of issue each series and class of Notes is assigned a credit rating which reflects the likelihood of full and timely payment to the Noteholders of interest on each interest payment date and the payment of principal on the final maturity date. A rating may be subject to revision, suspension or withdrawal at any time by the rating agencies if the Company's circumstances change.

Any change in the credit rating assigned to a Note would be used as an indicator as to the performance of the Company. No downgrade in credit ratings has been applied to the Company's Notes in the period under review and subsequently up to the date of approval of these accounts.

Although UK interest rates have remained low and currency exchange rates have experienced significant volatility in 2009, the Company's principal outflow, being the interest payable on the Notes, has been economically hedged using a series of swaps which match the terms of the Notes. This has provided certainty in terms of amounts due on the Notes and avoids fluctuations in payments.

The Company has made all necessary payments on the Notes in accordance with the scheduled repayment dates for the year ended 31 December 2009.

The Company's tax charge is based on the tax regime for securitisation companies. All fair value adjustments on derivative contracts are ignored for taxation purposes as tax is assessed on the cash retained as profit in the Company.

### **Policy and practice on payment of creditors**

The majority of the Company's payments are in relation to the Notes and are due monthly or quarterly in accordance with the terms of the Notes. Payments are subject to the receipt of principal and interest on the underlying mortgage pool held in Arkle Finance Trustee Ltd and the subsequent payment of the intercompany loans. All such payments were made on the due dates.

For trade creditors, the Company follows "The Better Payment Practice Code", published by the Department of Trade and Industry, regarding payments to suppliers. A copy of the code and information about it may be obtained from the Department of Trade and Industry, No. 1 Victoria Street, London, SW1H 0ET.

The Company's policy is to agree terms of payment with suppliers and these normally provide for settlement within 30 days after the date of the invoice, except where other arrangements have been negotiated. It is the policy of the Company to abide by the agreed terms of payment, provided the supplier performs according to the terms of the contract.

The Company owed no money to trade creditors at 31 December 2009 or at 31 December 2008.

### **Directors and Directors' interests**

The Directors of the Company at the end of the year were as follows:

Vincent M Rapley  
Jason C Bingham  
Gary L Staines

None of the directors had a beneficial interest in the shares of the Company, or of the ultimate holding company, Stanhope Gate Trustees Limited.

Ian D O'Meara resigned from the Board on 2 June 2009 and Jason C Bingham was appointed on the same day.

Gary L Staines is an employee of Lloyds TSB Bank plc.

### **Risk Management**

The Company's assets and liabilities are financial instruments as defined by IAS 32 "Financial Instruments: Presentation". The Company's financial instruments principally comprise inter-company loans to Funding 1, Notes issued in the capital markets, derivatives and cash and liquid resources. The principal risks arising from the Company's financial instruments are credit risk, interest rate risk and currency risk. All of the Company's financial assets and liabilities are linked to Sterling 3 month Libor either directly or via the use of derivative instruments. As such the Company has no market risk. Full disclosure of the Group's financial risk management policies, use of financial instruments and risk exposures is given in note 18 to the accounts.

The Company is also exposed to operational risks through a number of contracts with third parties who have agreed to provide operational support to the Company in accordance with the Programme Documentation. Mourant & Co. Capital (SPV) Limited has been appointed to provide corporate services in accordance with a corporate services

agreement. Other third parties have agreed to provide services with respect to the Notes including the paying agents, issuing entity swap providers and agent bank. Lloyds TSB Bank plc has been appointed as account bank and Cheltenham & Gloucester plc as cash manager on behalf of the company.

The principal business risks of the Company are set out in a number of asset and non-asset trigger events in the Programme Documentation (Asset trigger: Debit to AAA principal deficiency ledger; Non-asset triggers: Minimum Seller share below that required, Insolvency of seller, Termination of servicer not replaced within 60 days, and Minimum trust size breached). The occurrence of trigger events may lead to a draw on the AAA principal deficiency ledger and a different priority of payments of the Notes in accordance with established priorities. There have been no such trigger events since the inception of the Programme.

## **Employees**

The Company does not have any employees (2008: Nil).

## **Statement of Directors' Responsibilities**

Company law requires the directors to prepare financial statements for each financial year that give a true and fair view of the state of affairs of the Company.

The directors confirm that suitable accounting policies have been used and applied consistently in the year. They also confirm that reasonable and prudent judgements and estimates have been made in preparing the financial statements for the year to 31 December 2009 and that applicable accounting standards have been followed.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

So far as the directors are aware, there is no relevant audit information of which the Company's auditors are unaware, and the directors have taken all the steps that they ought to have taken as directors in order to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

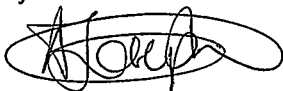
## **Auditors**

PricewaterhouseCoopers LLP have indicated their willingness to continue in office.

## **Statement of Going Concern**

The directors are satisfied that the Company has adequate resources to continue to operate for the foreseeable future and is financially sound. For this reason, they continue to adopt the going concern basis in preparing the financial statements. The negative reserves are as a result of fair value adjustments made in accordance with IFRSs and are expected to reverse in the future. There was no impact on the cash resources of the Company during the year as a result of these valuations.

By order of the board



Mourant & Co. Capital Secretaries Limited  
8<sup>th</sup> April 2010

Registered Office  
1<sup>st</sup> Floor  
Phoenix House  
18 King William Street  
London EC4N 7BP

## INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF ARKLE MASTER ISSUER PLC

We have audited the financial statements of Arkle Master Issuer Plc for the year ended 31 December 2009 which comprise the Statement of Comprehensive Income, the Balance Sheet, the Statement of Changes in Equity, the Cash Flow Statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

### Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

### Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements.

### Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2009 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

### Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

### Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.



Mark Hannam (Senior Statutory Auditor)  
for and on behalf of PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditors  
Leeds  
8<sup>th</sup> April 2010

**STATEMENT OF COMPREHENSIVE INCOME**  
**FOR THE YEAR ENDED 31 DECEMBER 2009**

|                                                     | Note | Year ended<br>31 Dec 2009 | Year ended<br>31 Dec 2008 |
|-----------------------------------------------------|------|---------------------------|---------------------------|
|                                                     |      | £'000                     | £'000                     |
| Interest receivable and similar income              | 3    | 425,736                   | 1,087,837                 |
| Interest payable and similar charges                | 4    | (423,541)                 | (1,086,162)               |
| <b>Net interest income</b>                          |      | <u>2,195</u>              | <u>1,675</u>              |
| Fair value gains and losses                         | 5    | 33,187                    | (20,956)                  |
| Operating expenses                                  | 6    | (2,190)                   | (1,670)                   |
| <b>Profit (Loss) before tax</b>                     |      | <u>33,192</u>             | <u>(20,951)</u>           |
| Taxation                                            | 7    | (1)                       | (3,202)                   |
| <b>Profit (Loss) attributable to equity holders</b> |      | <u>33,191</u>             | <u>(24,153)</u>           |

The profit shown above is derived from continuing operations. The Company operates in a single business segment and all of the Company's activities are in the UK.

There was no income or expense recognised directly in equity in the current year or preceding year.

The accompanying notes on pages 10 to 25 are an integral part of the Financial Statements.

Company number : 05941709

**BALANCE SHEET**  
**AT 31 DECEMBER 2009**

|                                     | <b>Note</b> | <b>As at<br/>31 Dec 2009</b> | <b>As at<br/>31 Dec 2008</b> |
|-------------------------------------|-------------|------------------------------|------------------------------|
|                                     |             | <b>£'000</b>                 | <b>£'000</b>                 |
| <b>Assets</b>                       |             |                              |                              |
| Loan to related company             | 8           | 17,227,992                   | 25,179,178                   |
| Derivatives                         | 9           | 898,288                      | 2,069,463                    |
| Trade and other receivables         | 10          | 16,796                       | 134,560                      |
| Cash and cash equivalents           |             | 37                           | 33                           |
| Other Debtors                       | 12          | 37                           | 37                           |
| <b>Total assets</b>                 |             | <b>18,143,150</b>            | <b>27,383,271</b>            |
| <b>Equity and liabilities</b>       |             |                              |                              |
| Debt securities in issue            | 13          | 18,142,073                   | 27,415,288                   |
| Derivatives                         | 9           | -                            | -                            |
| Current tax liability               |             | 1                            | 1                            |
| Trade and other payables            | 14          | 212                          | 309                          |
| <b>Total liabilities</b>            |             | <b>18,142,286</b>            | <b>27,415,598</b>            |
| Called up share capital             | 15          | 50                           | 50                           |
| Retained profits                    | 16          | 814                          | (32,377)                     |
| <b>Shareholders' equity</b>         |             | <b>864</b>                   | <b>(32,327)</b>              |
| <b>Total equity and liabilities</b> |             | <b>18,143,150</b>            | <b>27,383,271</b>            |

The Directors approved the accounts on 8<sup>th</sup> April 2010.



**Jason C Bingham**  
Director

The accompanying notes on pages 10 to 25 are an integral part of the Financial Statements.

**STATEMENT OF CHANGES IN EQUITY**  
FOR THE YEAR ENDED 31 DECEMBER 2009

|                               | <b>Share<br/>capital</b> | <b>Retained<br/>profits</b> | <b>Total</b> |
|-------------------------------|--------------------------|-----------------------------|--------------|
|                               | <b>£'000</b>             | <b>£'000</b>                | <b>£'000</b> |
| <b>Year ended 31 Dec 2009</b> |                          |                             |              |
| Balance at 1 Jan 2009         | 50                       | (32,377)                    | (32,327)     |
| Profit for the year           | -                        | 33,191                      | 33,191       |
| Balance at 31 Dec 2009        | <u>50</u>                | <u>814</u>                  | <u>864</u>   |

|                               | <b>Share<br/>capital</b> | <b>Retained<br/>profits</b> | <b>Total</b>    |
|-------------------------------|--------------------------|-----------------------------|-----------------|
|                               | <b>£'000</b>             | <b>£'000</b>                | <b>£'000</b>    |
| <b>Year ended 31 Dec 2008</b> |                          |                             |                 |
| Balance at 1 Jan 2008         | 50                       | (8,224)                     | (8,174)         |
| Loss for the year             | -                        | (24,153)                    | (24,153)        |
| Balance at 31 Dec 2008        | <u>50</u>                | <u>(32,377)</u>             | <u>(32,327)</u> |



**CASH FLOW STATEMENT**  
FOR THE YEAR ENDED 31 DECEMBER 2009

|                                                   | Year ended<br>31 Dec 2009 | Year ended<br>31 Dec 2008 |
|---------------------------------------------------|---------------------------|---------------------------|
|                                                   | £'000                     | £'000                     |
| <b>Operating Activities</b>                       |                           |                           |
| Interest receivable and similar income            | 541,972                   | 1,048,681                 |
| Interest from bank accounts                       | 1,528                     | 2                         |
| Payments to related party                         | (2,287)                   | (1,506)                   |
| Interest payable to Noteholders                   | (539,680)                 | (1,047,173)               |
| Interest payable on swap collateral               | (1,528)                   | -                         |
| Tax Paid                                          | (1)                       | (4)                       |
| <b>Net cash generated by operating activities</b> | <u>4</u>                  | <u>0</u>                  |
| <b>Investing Activities</b>                       |                           |                           |
| Payments to group company related to Issuances    | -                         | (21,500,000)              |
| Principal receipts from loan to related party     | 7,951,186                 | 8,686,942                 |
| <b>Net cash used for investing activities</b>     | <u>7,951,186</u>          | <u>(12,813,058)</u>       |
| <b>Financing Activities</b>                       |                           |                           |
| Proceeds from note issuance                       | -                         | 21,500,000                |
| Principal repayments to noteholders               | (7,951,186)               | (8,686,942)               |
| <b>Net cash generated by financing activities</b> | <u>(7,951,186)</u>        | <u>12,813,058</u>         |
| <b>Net increase in cash and cash equivalents</b>  | <b>4</b>                  | <b>0</b>                  |
| Change in cash and cash equivalents               | 4                         | 0                         |
| Cash and cash equivalents at beginning of year    | 33                        | 33                        |
| <b>Cash and cash equivalents at end of year</b>   | <u><b>37</b></u>          | <u><b>33</b></u>          |

The cashflow is presented using the direct method to improve the transparency of the accounts.

## **NOTES TO THE ACCOUNTS**

### **1. ACCOUNTING POLICIES**

The Company is domiciled in England.

#### **Statement of compliance**

The financial statements for the year ended 31 December 2009 have been prepared in accordance with International Financial Reporting Standards (IFRSs) and interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC) as adopted by the European Union. The standards applied by the Company are those endorsed by the European Union and effective at the date the financial statements are approved by the Board. However the Company has not utilised the 'carve out' provisions in respect of full fair value and portfolio hedging of core deposits in IAS39 'Financial Instruments: Recognition and Measurement' as adopted by the European Union. Consequently the financial statements comply with the International Financial Reporting Standards.

The principal accounting policies applied in the preparation of these financial statements are set out below and have been applied consistently in respect of the financial years ended 31 December 2009 and 31 December 2008.

The financial statements also comply with the relevant provisions of Part XV of the Companies Act 2006.

The financial statements have been prepared using the going concern basis. The directors have reviewed the expected future cash flows and believe they are adequate to meet the anticipated payments in accordance with the Programme Documentation. The directors also consider that additional safeguards are in place to cover any unexpected issues which may arise in light of the current market turbulence including access to a general cash reserve and the ability to defer payment in certain circumstances.

The financial statements are presented in Sterling which is the Company's functional and presentation currency and are presented to the nearest thousand pounds.

The financial information has been prepared under the historical cost convention, as modified by the revaluation of available-for-sale financial assets, financial assets at fair value through profit or loss and all derivative contracts, on the basis of IFRS.

#### **Revenue recognition**

Interest income and expense are recognised in the income statement for all interest-bearing financial instruments, including loans and advances, using the effective interest rate method. The effective interest rate method is a method of calculating the amortised cost of a financial asset or liability and of allocating the interest income or interest expense. The effective interest rate is the rate that exactly discounts the estimated future cash payments or receipts over the expected life of the instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the future cash flows are estimated after considering all the contractual terms of the instrument but not future credit losses.

#### **Accrued Interest**

Accrued interest has been incorporated within the outstanding balance of debt securities in issue on the balance sheet. A split between debt securities in issue and accrued interest can be found in Note 13.

#### **Taxation**

Current tax which is payable on taxable profits is recognised as an expense in the period in which the profits arise.

The Company's tax charge is based on the Permanent Tax Regime for securitisation companies. As such, deferred tax is not recognised on the difference between the accounting recognition of the mark to market fair value movement and the tax non-recognition of the movement. Therefore a 'tax base' under IAS12 is not generated and hence deferred tax is not recognised on the difference between the tax and accounting treatment.

## **Financial instruments**

The Company's financial instruments principally comprise intercompany loans to Funding 1, Notes issued in the capital markets, derivatives ("swaps") and cash and liquid resources. The main purpose of these financial instruments is to raise finance for Lloyds Banking Group. These financial instruments are classified in accordance with the principles of IAS 39.

The loans to Funding 1 are classified within "loans and receivables". The loans are held at amortised cost and are subject to impairment review in accordance with IAS 39.

Interest-bearing borrowings are stated at amortised cost.

## **Derivative financial instruments**

All derivatives are recognised at their fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and using valuation techniques, including discounted cash flow and options pricing models, as appropriate. Derivatives are carried in the balance sheet as assets when their fair value is positive and as liabilities when their fair value is negative. Changes in the fair value of any derivative instrument that is not part of a hedging relationship are recognised immediately in the income statement.

## **Cash and cash equivalents**

Cash and cash equivalents comprise cash in hand and on demand deposits.

## **Impairment of financial assets**

At each balance sheet date the Company assesses whether, as a result of one or more events occurring after initial recognition, there is objective evidence that the Loan to related company has become impaired.

Delinquencies and defaults on the underlying securitised assets will not result in an impairment loss if the cashflows from the asset pool are still expected to be sufficient to meet obligations under the limited recourse loan. Losses incurred on the securitised assets will not trigger an impairment as long as they do not exceed the credit enhancement granted by the Originator.

The amount of the loss is measured as the difference between the carrying amount of the Loan to the related company and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted with the original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement.

## **Dividends**

Dividends on ordinary shares are recognised in equity in the period in which they are paid.

## **Foreign currency translation**

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

## **Segment Reporting**

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risks and returns that are different from those of segments operating in other economic environments.

The directors of the Company consider that the entity has only one geographical and one business segment and therefore is not required to produce additional segmental disclosure.

## 2. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

The Company makes assumptions and estimates that affect the reported amounts of assets and liabilities. Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The accounting policies deemed critical to the Company's results and financial position, based upon materiality and significant judgments and estimates, are discussed below:

### Effective Interest Rate

In calculating the effective interest rate of financial instruments the Company takes into account interest received or paid, fees and commissions paid or received, expected early redemptions and related penalties and premiums and discounts on acquisition or issue that are integral to the yield as well as incremental transaction costs.

For the purpose of the effective yield calculation, it has been assumed that the average expected life of the Notes in issue will end at the expected maturity date, based on the payment experience to date. This may not be the case in practice.

### Fair Value Calculations

Fair value is defined as the value at which assets, liabilities or positions could be closed out or sold in a transaction with a willing and knowledgeable counterparty. Fair value is based upon cashflow models which use, wherever possible, independently sourced market parameters such as interest rate yield curves and currency rates. Other factors are also considered, such as counterparty credit quality and liquidity.

## 3. INTEREST RECEIVABLE AND SIMILAR INCOME

|                                                  | Year ended<br>31 Dec 2009 | Year ended<br>31 Dec 2008 |
|--------------------------------------------------|---------------------------|---------------------------|
|                                                  | £'000                     | £'000                     |
| Interest receivable from loan to related company | 424,208                   | 1,087,837                 |
| Bank interest receivable on collateral           | 1,528                     | -                         |
|                                                  | <u>425,736</u>            | <u>1,087,837</u>          |

## 4. INTEREST PAYABLE AND SIMILAR CHARGES

|                                          | Year ended<br>31 Dec 2009 | Year ended<br>31 Dec 2008 |
|------------------------------------------|---------------------------|---------------------------|
|                                          | £'000                     | £'000                     |
| Interest payable on debt securities      | 422,013                   | 1,086,162                 |
| Interest payable on swap collateral held | 1,528                     | -                         |
|                                          | <u>423,541</u>            | <u>1,086,162</u>          |

Interest payable relates to swap collateral held due to a counterparty rating downgrade.

## 5. FAIR VALUE GAINS AND LOSSES

|                   | Year ended<br>31 Dec 2009 | Year ended<br>31 Dec 2008 |
|-------------------|---------------------------|---------------------------|
|                   | £'000                     | £'000                     |
| Fair Value Gains  | 1,204,362                 | 2,041,413                 |
| Fair Value Losses | (1,171,175)               | (2,062,369)               |
|                   | <u>33,187</u>             | <u>(20,956)</u>           |

Fair value movements have arisen on the translation of currency swaps into Sterling using exchange rates as at the Balance Sheet date.

## 6. OPERATING EXPENSES

|                                                      | Year ended<br>31 Dec 2009 | Year ended<br>31 Dec 2008 |
|------------------------------------------------------|---------------------------|---------------------------|
|                                                      | £'000                     | £'000                     |
| Administration charges – Cheltenham & Gloucester plc | <u>2,190</u>              | <u>1,670</u>              |

The Company has no employees (2008: Nil). No management fee is charged to the Company for the services of the directors. A management fee for administration services is charged by Cheltenham & Gloucester plc.

### Auditors' remuneration:

The audit fees for the Company are paid for by Funding 1. The fee for the current year was £12,000 (year to 31 Dec 2008: £11,000).

## 7. TAXATION

Analysis of charge in year

|                                     | Year ended<br>31 Dec 2009 | Year ended<br>31 Dec 2008 |
|-------------------------------------|---------------------------|---------------------------|
|                                     | £'000                     | £'000                     |
| <b>UK corporation tax</b>           |                           |                           |
| Current tax on profits for the year | 1                         | 1                         |
| Prior year corporation tax          | -                         | (2)                       |
| Current year deferred tax           | -                         | -                         |
| Prior year deferred tax             | -                         | 3,203                     |
|                                     | <u>1</u>                  | <u>3,202</u>              |

The charge for tax on the profit for the year to 31 December 2009 is based on a UK corporation tax rate of 21.00 per cent (31 Dec 2008: 20.75 per cent).

Factors affecting tax charge for the period

|                                                                           | Year ended<br>31 Dec 2009 | Year ended<br>31 Dec 2008 |
|---------------------------------------------------------------------------|---------------------------|---------------------------|
|                                                                           | £'000                     | £'000                     |
| Tax charge /( credit) at UK corporation tax rate of 21%<br>(2008: 20.75%) | 6,970                     | (4,347)                   |
| Deferred tax prior year                                                   | -                         | 3,203                     |
| Corporation tax prior year                                                | -                         | (2)                       |
| Fair value gains and losses                                               | (6,969)                   | 4,348                     |
| Total tax charge / (credit)                                               | <u>1</u>                  | <u>3,202</u>              |

8. LOAN TO RELATED COMPANY

|                                  | As at<br>31 Dec 2009 | As at<br>31 Dec 2008 |
|----------------------------------|----------------------|----------------------|
|                                  | £'000                | £'000                |
| Loan to Arkle Funding (No.1) Ltd | <u>17,227,992</u>    | <u>25,179,178</u>    |

The intercompany loans to Funding 1 are all denominated in Sterling and are at variable rates of interest, based on LIBOR for three-month Sterling deposits. Such loans have ultimately been secured against a beneficial interest in a mortgage portfolio held in trust on behalf of Funding 1.

Funding 1's ability to pay amounts due on the intercompany loans will depend mainly upon it receiving sufficient revenue receipts and principal from Arkle Finance Trustee Limited; receiving the required funds from the Funding 1 swap provider; and amounts available in the reserve funds. In the case of a shortfall, holders of the Notes may, subject to what other sources of funds are available to the Company, receive less than the full interest and/or principal than would otherwise be due on the Notes. The repayment of the intercompany loans will coincide with the repayment of the Notes.

9. DERIVATIVES

The principal derivatives used by the Company are exchange rate and interest rate contracts.

These contracts include forward foreign exchange contracts including interest rate basis swaps. A forward foreign exchange contract is an agreement to buy or sell a specified amount of foreign currency on a specified future date at an agreed rate. Currency swaps generally involve the exchange of interest payment obligations denominated in different currencies; the exchange of principal is actual.

The principal amount of the contract does not represent the Company's real exposure to credit risk which is limited to the current cost of replacing contracts with a positive value to the Company should the counterparty default. To reduce credit risk the Company only deals with highly rated counterparties and uses credit enhancement techniques such as collateralisation, where security is provided against the exposure. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and using valuation techniques, including discounted cash flow and options pricing models, as appropriate.

The residual maturity of the notional principal amount and fair value of instruments entered into was:

|                                                | 1 year<br>or less | 1 to 5<br>Years | Total     |
|------------------------------------------------|-------------------|-----------------|-----------|
|                                                | £'000             | £'000           | £'000     |
| 31 December 2009:                              |                   |                 |           |
| <b>Exchange &amp; Interest rate contracts:</b> |                   |                 |           |
| Notional principal amount                      | -                 | 3,870,942       | 3,870,942 |
| <b>Fair Value</b>                              |                   |                 |           |
| Assets                                         | -                 | 898,288         | 898,288   |
| Liabilities                                    | -                 | -               | -         |

|                                                | 1 year<br>or less | 1 to 5<br>years | Total     |
|------------------------------------------------|-------------------|-----------------|-----------|
|                                                | £'000             | £'000           | £'000     |
| 31 December 2008:                              |                   |                 |           |
| <b>Exchange &amp; Interest rate contracts:</b> |                   |                 |           |
| Notional principal amount                      | 2,311,436         | 3,870,942       | 6,182,378 |
| <b>Fair Value</b>                              |                   |                 |           |
| Assets                                         | 725,842           | 1,343,621       | 2,069,463 |
| Liabilities                                    | -                 | -               | -         |

## 10. TRADE AND OTHER RECEIVABLES

|                                   | As at<br>31 Dec 2009 | As at<br>31 Dec 2008 |
|-----------------------------------|----------------------|----------------------|
|                                   | £'000                | £'000                |
| Due from Arkle Funding (No.1) Ltd | 16,796               | 134,560              |

## 11. DEFERRED TAX

|                                    | As at<br>31 Dec 2009 | As at<br>31 Dec 2008 |
|------------------------------------|----------------------|----------------------|
|                                    | £'000                | £'000                |
| At opening of year                 | -                    | 3,203                |
| Income statement (charge) / credit | -                    | (3,203)              |
| At close of year                   | -                    | -                    |

Note 7 provides further information regarding the charge for the prior year.

## 12. OTHER DEBTORS

|                      | As at<br>31 Dec 2009 | As at<br>31 Dec 2008 |
|----------------------|----------------------|----------------------|
|                      | £'000                | £'000                |
| Unpaid share capital | <u>37</u>            | <u>37</u>            |

The Company has issued share capital of £50,000 comprising 50,000 ordinary shares of £1 each, of which 49,999 were partly paid to £0.25 each.

## 13. DEBT SECURITIES IN ISSUE

Debt securities in issue at 31 December 2009 comprised £18,125.5 million (2008: £27,281.0 million) raised in connection with the securitisation of mortgages originated within the Lloyds Banking Group.

At 31 December 2009

|                                        | 1 year<br>or less | 1 to 5<br>years   | Total             |
|----------------------------------------|-------------------|-------------------|-------------------|
|                                        | £'000             | £'000             | £'000             |
| <b>Currency and Rate Fixing</b>        |                   |                   |                   |
| GBP – priced against 3 month GBP LIBOR | 4,639,750         | 8,717,300         | 13,357,050        |
| Weighted average margin +0.18%         |                   |                   |                   |
| USD – priced against 3 month USD LIBOR | -                 | 2,713,368         | 2,713,368         |
| Weighted average margin +0.10%         |                   |                   |                   |
| EUR – priced against 3 month EURIBOR   | -                 | 2,055,071         | 2,055,071         |
| Weighted average margin +0.14%         |                   |                   |                   |
|                                        | <u>4,639,750</u>  | <u>13,485,739</u> | <u>18,125,489</u> |
| Interest Payable on Notes              | 16,584            | -                 | 16,584            |
|                                        | <u>4,656,334</u>  | <u>13,485,739</u> | <u>18,142,073</u> |

At 31 December 2008

|                                        | 1 year<br>or less | 1 to 5<br>years   | Total             |
|----------------------------------------|-------------------|-------------------|-------------------|
|                                        | £'000             | £'000             | £'000             |
| <b>Currency and Rate Fixing</b>        |                   |                   |                   |
| GBP – priced against 3 month GBP LIBOR | 5,639,750         | 13,357,050        | 18,996,800        |
| Weighted average margin +0.18%         |                   |                   |                   |
| USD – priced against 3 month USD LIBOR | 2,823,283         | 3,018,063         | 5,841,346         |
| Weighted average margin +0.09%         |                   |                   |                   |
| CAD – priced against 1 month CBA       | 223,826           | -                 | 223,826           |
| Margin +0.08%                          |                   |                   |                   |
| EUR – priced against 3 month EURIBOR   | -                 | 2,219,065         | 2,219,065         |
| Weighted average margin +0.14%         |                   |                   |                   |
|                                        | <u>8,686,859</u>  | <u>18,594,178</u> | <u>27,281,037</u> |
| Interest Payable on Notes              | 134,251           | -                 | 134,251           |
|                                        | <u>8,821,110</u>  | <u>18,594,178</u> | <u>27,415,288</u> |



There have been no defaults in principal, interest or other breaches with respect to liabilities in the year.

#### 14. TRADE AND OTHER PAYABLES

|                                   | As at<br>31 Dec 2009 | As at<br>31 Dec 2008 |
|-----------------------------------|----------------------|----------------------|
|                                   | £'000                | £'000                |
| Amounts owed to Group Undertaking | <u>212</u>           | <u>309</u>           |

The Company has no contingent liabilities or commitments (2008: £nil). These amounts are due within one year.

#### 15. CALLED UP SHARE CAPITAL

|                                                                | As at<br>31 Dec 2009 | As at<br>31 Dec 2008 |
|----------------------------------------------------------------|----------------------|----------------------|
|                                                                | £'000                | £'000                |
| Authorised: 50,000 ordinary shares of £1 each                  | <u>50</u>            | <u>50</u>            |
| Issued and fully paid: 1 ordinary share of £1                  | 0                    | 0                    |
| Issued and one quarter paid: 49,999 ordinary shares of £1 each | <u>13</u>            | <u>13</u>            |

The Company was registered as Arkle Master Issuer plc in England and Wales on 20 September 2006 as a public limited company, with authorised share capital of £50,000 comprising 50,000 ordinary shares of £1 each. All of the authorised share capital of £50,000 was issued, of which 49,999 were partly paid to £0.25 each and one share was fully paid up.

#### 16. RETAINED PROFITS

|                            | As at<br>31 Dec 2009 | As at<br>31 Dec 2008 |
|----------------------------|----------------------|----------------------|
|                            | £'000                | £'000                |
| At opening of year         | (32,377)             | (8,224)              |
| Profit (Loss) for the year | <u>33,191</u>        | <u>(24,153)</u>      |
| At close of year           | <u>814</u>           | <u>(32,377)</u>      |

#### 17. RELATED PARTY TRANSACTIONS

A number of transactions are entered into with related parties as part of the Company's normal business.

The related parties are Funding 1, Lloyds Banking Group plc, notably Cheltenham & Gloucester plc and Lloyds TSB Bank plc by virtue of their various roles and inputs into securitisation arrangements to which the Company is a party.

These transactions include a loan to Funding 1, a banking relationship with Lloyds TSB Bank plc and a cash management fee payable to Cheltenham & Gloucester plc. The cash management fee amounted to £2,190,000 for the year ended 31 December 2009 (2008: £1,670,000).

## Arkle Master Issuer plc

The loan to Funding 1 is not considered to be impaired and as such no provision for impairment has been included for this asset.

The financial statements include the following related party transactions:

|                                                            | As at<br>31 Dec<br>2009 or for<br>the year<br>then ended | As at<br>31 Dec<br>2008 or for<br>the year<br>then ended |
|------------------------------------------------------------|----------------------------------------------------------|----------------------------------------------------------|
|                                                            | £'000                                                    | £'000                                                    |
| <b>Interest receivable and similar income</b>              |                                                          |                                                          |
| Interest receivable on intercompany loans                  | 424,208                                                  | 1,087,837                                                |
| <b>Interest payable and similar charges</b>                |                                                          |                                                          |
| Interest payable on Notes held by Lloyds Banking Group plc | 294,459                                                  | 527,849                                                  |
| <b>Assets</b>                                              |                                                          |                                                          |
| Loan to Arkle Funding (No. 1) Limited                      | 17,227,992                                               | 25,179,178                                               |
| Cash and cash equivalents                                  | 37                                                       | 33                                                       |
| Interest due from Arkle Funding (No. 1) Limited            | 16,796                                                   | 134,560                                                  |
| Unpaid share capital                                       | 37                                                       | 37                                                       |
| <b>Liabilities</b>                                         |                                                          |                                                          |
| Notes held by Lloyds Banking Group plc                     | 12,076,340                                               | 17,454,480                                               |
| Interest payable on Notes held by Lloyds Banking Group plc | 11,855                                                   | 93,541                                                   |
| Amounts owed to group undertaking                          | 212                                                      | 309                                                      |

## 18. MANAGEMENT OF RISK

The Company's activities expose it to a number of financial risks including credit risk, foreign currency risk and liquidity risk. For this reason, the Company devotes considerable resource to maintaining effective controls to manage, measure and mitigate each of these risks. The Company uses derivative financial instruments to hedge certain risk exposures.

### Credit risk

Credit risk arises where there is a possibility that a counterparty may default.

The Company relies on repayment of the intercompany loans from Funding 1 on the due dates to repay the Notes, therefore, the primary credit risk of the Company relates to the default on the unlisted security with Funding 1. The primary credit risk of Funding 1 relates to the credit risk associated with the securitised pool of mortgages originated within the Lloyds TSB Group. The likelihood of defaults in the mortgage pool and the amounts that may be recovered in the event of default are related to a number of factors and may vary according to characteristics and product type. Significant changes in the economy, or in the health of a particular geographical zone that represents a concentration in the securitised assets, could also affect the cash flows from the mortgage pool.

To mitigate this risk, credit enhancement is provided to the transaction within Funding 1 in the form of excess spread and a reserve fund. Funding 1's share of the income on the mortgage pool is expected to exceed the interest payable on the loan from Master Issuer. This excess income (excess spread) is available to make good any reduction in the principal balance of the mortgage pool as a result of defaults by customers. Funding 1's share of losses in the mortgage pool is recorded in a principal deficiency ledger. On distribution dates excess spread is utilised to eliminate the balance on the principal deficiency ledger.

In addition, Lloyds TSB Bank plc provided a start up loan to Funding 1 to create a reserve fund which can be used in certain circumstances to meet any deficit in revenue or to repay amounts of principal. Therefore, delinquencies

and defaults on the underlying securitised assets will not result in a default on the intercompany loan as long as they do not exceed the credit enhancement provided by the excess spread and reserve fund. Funding 1's share of losses in the mortgage pool covered by excess spread in the year to 31 December 2009 was £12,637,000 (2008; £3,098,000). There have been no principal drawings on the reserve fund which is fully funded and at 31 December 2009 was £493,300,000 (2008; £493,300,000).

The Company has a concentration of risk to the Originator. The underlying mortgage assets of the securitisation are all in the UK market. The nature of the residential mortgage portfolio means there is no significant counterparty credit risk in relation to the underlying mortgage pool.

The Company assesses its counterparties for credit risk before contracting with them. Credit rating is the main method used to measure credit risk. In accordance with the criteria of the Rating Agencies that rate the Notes, the Programme Documentation contains various rating triggers linked to each counterparty, which require certain actions to be taken if triggers are breached.

All derivatives activity is subject to credit approvals based upon counterparty credit ratings. The maximum credit risk exposure to all counterparties on derivatives is £897.5 million (2008: £2,101.9 million). In the event that a swap counterparty is downgraded by a rating agency below the rating(s) specified in the relevant swap agreement, the relevant swap provider will be required to take certain remedial measures as defined in that agreement which may include providing collateral for its obligations under the relevant swap, arranging for its obligations to be transferred to an entity with sufficient rating, or taking such other action as it may agree with the relevant rating agency.

| Counterparty           |                           | Rating as at<br>31 Dec 2009 | Rating as at<br>date of approval of<br>accounts |
|------------------------|---------------------------|-----------------------------|-------------------------------------------------|
|                        |                           | (Moody's/S&P/Fitch)         | (Moody's/S&P/Fitch)                             |
| Account bank           | Lloyds TSB plc            | P-1/A-1/F1+<br>Aa3/A+/AA-   | P-1/A-1/F1+<br>Aa3/A+/AA-                       |
| Currency swap provider | Deutsche Bank AG, London  | P-1/A-1/F1+<br>Aa1/A+/AA-   | P-1/A-1/F1+<br>Aa1/A+/AA-                       |
| Currency swap provider | Barclays Bank plc, London | P-1/A-1+/F1+<br>Aa3/AA-/AA- | P-1/A-1+/F1+<br>Aa3/AA-/AA-                     |

### Financial assets subject to credit risk

For the purposes of the Company's disclosures regarding credit quality, financial assets subject to credit risk are Held to Maturity assets. At the balance sheet date all financial assets subject to credit risk were neither past due nor impaired.

|                                            | As at<br>31 Dec 2009 | As at<br>31 Dec 2008 |
|--------------------------------------------|----------------------|----------------------|
|                                            | £'000                | £'000                |
| Loan to related company -Unlisted Security | 17,227,992           | 25,179,178           |
| Derivatives                                | 898,288              | 2,069,463            |
| Trade and other receivables                | 16,796               | 134,560              |
| Cash and cash equivalents                  | 37                   | 33                   |

The Company meets its obligation on the notes issued from the cash flows it receives from Funding 1. These represent the only recourse for the Company. As a consequence, the credit quality of the mortgage loans indicates the capacity of the Company to service its payments, although the mortgages remain on the balance sheet of Lloyds TSB Bank plc and the structure of the securitisation provides for other credit enhancements.

## Securitised mortgage assets

Securitised mortgage loans can be analysed according to the rating systems used by the Company and originator when assessing customers and counterparties.

For the purposes of the Company's disclosures regarding credit quality, securitised mortgage loans subject to credit risk have been analysed as follows:

|                               | As at<br>31 Dec<br>2009 | As at<br>31 Dec<br>2008 |
|-------------------------------|-------------------------|-------------------------|
|                               | £'000                   | £'000                   |
| Neither past due nor impaired | 16,649,883              | 24,534,384              |
| Past due but not impaired     | 334,940                 | 500,285                 |
| Impaired                      | 228,293                 | 142,561                 |
| Total                         | <u>17,213,116</u>       | <u>25,177,230</u>       |

Securitised loans and advances which are past due but not impaired:

|               | As at<br>31 Dec<br>2009 | As at<br>31 Dec<br>2008 |
|---------------|-------------------------|-------------------------|
|               | £'000                   | £'000                   |
| 0-30 days     | 159,485                 | 244,852                 |
| 30-60 days    | 67,259                  | 105,141                 |
| 60-90 days    | 42,649                  | 62,748                  |
| 90-180 days   | 65,547                  | 87,544                  |
| Over 180 days | -                       | -                       |
| Total         | <u>334,940</u>          | <u>500,285</u>          |

A financial asset is 'past due' if a counterparty has failed to make a payment when contractually due.

The number and value of loans currently in arrears will have a bearing on the receipt of cash by the Company. Key indicators are as follows:

At 31 December 2009, 4,662 accounts were in arrears by three or more months which represent 1.4% of the mortgage pool (31 Dec 2008: 2,805 accounts, 0.8%)

At 31 December 2009, the number of properties in possession amounted to 148 (31 December 2008: 214 properties)

Collateral held against retail mortgage lending is principally comprised of residential properties; their fair value has been estimated based upon the last actual valuation, adjusted to take into account subsequent movements in the Halifax House Price Index, after making allowance for indexation error and dilapidations. The resulting valuation has been limited to the principal amount of the outstanding advance in order to provide a clearer representation of the Company's credit exposure.

## Foreign currency risk

The Company's assets are denominated in sterling. However, during the year, the Company had Notes denominated in US Dollars, Euros and Canadian Dollars. It is therefore exposed to currency risk as the value of the

## Arkle Master Issuer plc

notes will fluctuate due to changes in USD, EUR and CAD exchange rates and in US, Euro and Canadian LIBOR rates.

To manage this risk, the Company entered into cross currency swaps with external counterparties at the time of the notes issuance (see Credit Risk above). The contractual notional amounts of the cross currency swaps correspond to the amount of the notes issued in USD, Euro and CAD and therefore mitigate the Company's exposure to currency risk.

|                                                                        | As at<br>31 Dec<br>2009<br>£'000 | As at<br>31 Dec<br>2008<br>£'000 |
|------------------------------------------------------------------------|----------------------------------|----------------------------------|
| Sterling value of asset backed notes on date of issue                  | 3,870,942                        | 6,182,378                        |
| Notional principal amounts of the outstanding cross currency contracts | <u>3,870,942</u>                 | <u>6,182,378</u>                 |

Currency debt securities and associated swaps are valued as follows:

|                                                    | As at<br>31 Dec<br>2009<br>£'000 | As at<br>31 Dec<br>2008<br>£'000 |
|----------------------------------------------------|----------------------------------|----------------------------------|
| <b>US Dollar</b>                                   |                                  |                                  |
| Debt securities in issue                           | (2,713,368)                      | (5,841,346)                      |
| Notional principal amounts of the outstanding      |                                  |                                  |
| Cross currency contracts at the contracted rate    | 2,314,397                        | 4,448,214                        |
| Fair value of outstanding cross currency contracts | 394,082                          | 1,355,576                        |
| <b>Canadian Dollar</b>                             |                                  |                                  |
| Debt securities in issue                           | -                                | (223,826)                        |
| Notional principal amounts of the outstanding      |                                  |                                  |
| Cross currency contracts at the contracted rate    | -                                | 177,620                          |
| Fair value of outstanding cross currency contracts | -                                | 45,232                           |
| <b>Euro</b>                                        |                                  |                                  |
| Debt securities in issue                           | (2,055,071)                      | (2,219,065)                      |
| Notional principal amounts of the outstanding      |                                  |                                  |
| Cross currency contracts at the contracted rate    | 1,556,545                        | 1,556,545                        |
| Fair value of outstanding cross currency contracts | 504,207                          | 668,655                          |

As a result of these highly effective swaps there is no sensitivity to movements in currency exchange rates. However, in the event of default by a counterparty, the fair value would be the cost of replacing the swap in the market.

### Liquidity risk

The ability of the Company to make interest payments under the currency swaps, pay interest on the notes and to pay its other expenses is dependant upon the Company receiving sufficient cash flow from Funding 1 and receiving the amounts due from swap counterparties.

Principal repayments are made on the notes in accordance with the Company's principal priority of payments and reflect the amount of principal collection on the internal loan notes.

The Company is only required to make payments on the notes to the extent it has received sufficient cash flows from Funding 1 in relation to the intercompany loans. Funding 1 will seek to accumulate funds from its share of the Trust over a specified period as set out in the Programme Documentation in order to repay the intercompany loans

## Arkle Master Issuer plc

to Master Issuer in accordance with the expected maturity dates. The amount of funds accumulated will depend on the rate of repayment of loan principal within the underlying mortgage pool and is subject to prepayment risk as detailed below.

If insufficient funds are received by Funding 1 to repay the intercompany loans, then the Notes may not be paid in full and a part of the Notes may be deferred to subsequent periods. Such deferred amounts will be due but not payable until funds are available in accordance with the relevant priority of payments. Variations in the rate of prepayment of principal on the loans may affect each series and class of Notes differently.

The liquidity tables reflect the undiscounted cash payments which will fall due until the expected payment date as defined in the Programme documentation.

|                          | Carrying<br>Value | Contractual<br>Repayment<br>value | <1 Month | 1–3 Months     | 3 Months<br>–1 Year | 1–5<br>Years      | >5<br>Years |
|--------------------------|-------------------|-----------------------------------|----------|----------------|---------------------|-------------------|-------------|
|                          | £'000             | £'000                             | £'000    | £'000          | £'000               | £'000             | £'000       |
| <b>31 December 2009</b>  |                   |                                   |          |                |                     |                   |             |
| Debt securities in issue | 18,142,073        | 18,281,834                        | -        | 36,982         | 4,700,274           | 13,544,578        | -           |
| Trade and other payables | 212               | 212                               | -        | 212            | -                   | -                 | -           |
| <b>Total</b>             | <b>18,142,285</b> | <b>18,282,046</b>                 | <b>-</b> | <b>37,194</b>  | <b>4,700,274</b>    | <b>13,544,578</b> | <b>-</b>    |
| <b>31 December 2008</b>  |                   |                                   |          |                |                     |                   |             |
| Debt securities in issue | 27,415,288        | 29,370,942                        | -        | 392,850        | 9,351,821           | 19,626,271        | -           |
| Trade and other payables | 309               | 309                               | -        | 309            | -                   | -                 | -           |
| <b>Total</b>             | <b>27,415,597</b> | <b>29,371,251</b>                 | <b>-</b> | <b>393,159</b> | <b>9,351,821</b>    | <b>19,626,271</b> | <b>-</b>    |

### Prepayment risks

Cash flows on the loan to the Trust within Funding 1 ("Deemed Loan to Originator") are dependent on the underlying mortgage loans which have a latest maturity of 2050. However, in the normal course of business, a proportion of borrowers repay their loan in advance of their contractual maturity. As a result the weighted average life of the loan to the Trust and of the Notes is likely to be significantly less than that implied by the contractual maturity dates of the mortgage pool.

The term of the Notes specifies that payments on the Notes will only be made to the extent that sufficient cashflows have been received from the Company's assets. The terms of the currency swaps also specify that the principal amounts of the swaps will amortise to match the outstanding amount of the currency denominated Notes to which they relate.

The rate of prepayment of loans is influenced by a wide variety of economic, social and other factors, including prevailing mortgage market interest rates, the availability of alternative financing programmes, local and regional economic conditions and homeowner mobility. In the event that prepayment rates on the mortgage pool reduce, principal repayments on the loan to the originator and on the Notes may be spread over a longer period.

The Constant Prepayment Rate ("CPR") for the underlying mortgage pool as detailed within the Trustee Report is as follows:

|                  | Monthly CPR % | 1-month<br>annualised % | 3-month<br>annualised % | 12-month<br>annualised % |
|------------------|---------------|-------------------------|-------------------------|--------------------------|
| 31 December 2009 | 1.51          | 16.70                   | 16.36                   | 16.99                    |
| 31 December 2008 | 1.49          | 16.49                   | 21.95                   | 25.93                    |

## 19. FAIR VALUES OF FINANCIAL ASSETS AND LIABILITIES

### Debt Securities In Issue

The notional principal as at 31 December 2009 was £17,228.0 million (2008: £25,179.2 million) and the fair value as at 31 December 2009 was £17,719.8 million (2008: £24,735.8 million). The fair values have been calculated taking into account current market values, by discounting the expected cash flows by the prevailing market rates for debt securities of similar credit risk and remaining maturity.

### Derivatives

Exchange rate swaps are held with counterparties external to the Group and are held to manage exchange rate risk for the securitised notes. The notional principal as at 31 December 2009 was £3,870.9 million (2008: £6,182.4 million) and the net fair value, which has been recognised in the balance sheet on a gross basis, was £898.3 million (2008: £2,069.5 million).

The swaps have been valued by discounting future cash flows, which is a valuation method consistent with commonly used market techniques. All inputs into valuation models adopted by the Company are obtained from observable market data. For this reason, in accordance with "IFRS 7 Financial Instruments: Disclosures", the fair value measurement is considered to be level 2 in the Fair Value Hierarchy. The change in Fair Value that has been calculated using this calculation technique has been recognised in the income statement for the year ended 31 December 2009.

## 20. FUTURE DEVELOPMENTS

The following pronouncements will be relevant to the Company but were not effective at 31 December 2009 and have not been applied in preparing these financial statements.

| Pronouncement                                                                                  | Nature of Change                                                                                                                                                                                                                                                                                                                                                                                                     | Effective Date                                                                                                       |
|------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------|
| Amendment to IAS 39 Financial Instruments: Recognition and Measurement – Eligible Hedged Items | Clarifies how the principles underlying hedge accounting should be applied in particular situations.                                                                                                                                                                                                                                                                                                                 | Annual periods beginning on or after 1 July 2009.                                                                    |
| Improvements to IFRSs (issued April 2009)                                                      | Sets out minor amendments to IFRS standards as part of annual improvements process                                                                                                                                                                                                                                                                                                                                   | Dealt with on a standard by standard basis but not earlier than annual periods beginning on or after 1 January 2010. |
| IFRS 9 Financial Instruments: Classification and Measurement                                   | Simplifies the way entities will classify financial assets and reduces the number of classification categories to two; fair value and amortised cost. The existing available-for-sale and held-to-maturity categories have been eliminated. Classification will be made on the basis of the objectives of the entity's business model for managing the assets and the characteristics of the contractual cash flows. | Annual periods beginning on or after 1 January 2013.                                                                 |
| IAS24 Related Party Disclosures                                                                | Simplifies the definition of a related party and provides a partial exemption from the disclosure requirements for government related entities.                                                                                                                                                                                                                                                                      | Annual periods beginning on or after 1 January 2011.                                                                 |

## 21. PARENT COMPANIES

The immediate parent company is Arkle PECO Holdings Limited for which Stanhope Gate Trustees Limited holds the shares in trust for the benefit of certain discretionary objects (which do not include Lloyds TSB Bank or any entity connected with Lloyds TSB Bank). For accounting purposes, the Company's ultimate parent and controlling party is Lloyds Banking Group plc (formerly Lloyds TSB Group plc). The Company's results are included within the consolidated financial statements of Lloyds Banking Group plc. Copies of the group accounts may be obtained from the Company Secretary's Office, Lloyds Banking Group plc, 25 Gresham Street, London EC2V 7HN.



**Arkle Master Issuer plc**

**Arkle Master Issuer plc  
Registered Office  
1st Floor  
Phoenix House  
18 King William Street  
London  
EC4N 7BP**

**Registered in England No. 05941709**